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BEFORE THE ARIZONA CORPORATION COMMISSION

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GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

IN THE MATTER OF THE GENERIC INVESTIGATION OF REGULATORY AND RATE INCENTIVES FOR GAS AND ELECTRIC UTILITIES	DOCKET NO. E-00000J-08-0314 DOCKET NO. G-00000C-08-0314 **TUCSON ELECTRIC POWER COMPANY, UNS ELECTRIC, INC. AND UNS GAS, INC.'S ADDITIONAL COMMENTS ON PROPOSED RULES**

Tucson Electric Power Company ("TEP"), UNS Electric, Inc. ("UNS Electric") and UNS Gas, Inc. (UNS Gas"), collectively the "Companies", through undersigned counsel, hereby file additional information relevant to Energy Efficiency ("EE") funding, programs and standards. The Companies filed an initial draft of proposed EE Rules with the Arizona Corporation Commission ("Commission") on June 3, 2009, in which the Companies stated that they would have additional comments. The Companies respectfully request the Commission to consider the following in conjunction with the Companies' proposed EE Rules:

Overview

The Companies support the Commission's desire to promote EE through programs that are economical and produce the desired results. However, as the Commission workshops have revealed, developing a comprehensive and effective EE program involves many complexities. Given the need for continuing fixed cost recovery by utilities in the face of decreasing volumetric use and the need to cover the actual cost of implementing the EE programs, any efficiency rules should be set based on concrete analyses to ensure that the rules do not adversely impact rate payers or the utilities. The Companies are concerned about selecting an aggressive target number without sufficient analytical support. Moreover, other near-term requirements, such as Federal EE mandates, may conflict with any specific Arizona requirements, leading to abrupt and costly alterations to utility EE programs.

Although EE programs represent an important long-term resource planning element, allowing the Federal requirements – along with the underlying studies supporting those requirements – to be developed may be prudent, particularly given the clear message that such elements are on the near-term horizon in light of the current Federal energy priorities. That approach will also eliminate potential inefficiencies in developing parallel programs that may be inherently inconsistent.

I. <u>Comments on Potential Rules.</u>

A. Fixed Cost Recovery Shortfall.

A rule requiring a utility (with its fixed cost presently being recovered through volumetric rate structures) to decrease sales without a corresponding mechanism in place to allow a reasonable opportunity to recover its prudently incurred fixed cost will result in unjust and unreasonable rates. The Companies are supportive of the societal goals being sought by these new rules, but the rules need a mechanism to provide a reasonable opportunity for a utility to recover the costs of meeting the rules (including fixed cost shortfalls) outside of filing a rate case each and every year.

This is a critical topic with widely disparate positions between parties. In the EE workshops, the Companies have offered a middle ground solution that is a simple and effective approach to address this issue. The Companies' proposal recovers the Fixed Cost Shortfall due only to EE/Demand Side Management ("DSM") measures, and only between rate cases. Each rate case would reset both the base cost recovery rate and the previous years' volumes. Without such a mechanism, a utility does not have a reasonable opportunity to recover its costs of providing service, including a reasonable return on its investments, between rate cases and, therefore would need to file frequent rate cases.

A timely and effective mechanism to recover shortfalls in the recovery of fixed costs is critical to the effective execution of an EE Standard. Therefore, the Companies argue the

Commission should authorize such fixed cost recovery shortfall in the Companies' proposed EE Rules as indicated below:

Rule R14-2-XXX8 - Fixed Cost Recovery Shortfall

The Commission shall authorize utilities to collect shortfalls in the recovery of fixed costs incurred in connection with EERS as follows:

(A) Utility shall file within 120 days of approval of this standard a Fixed Cost Recovery Shortfall Report supporting the per kWh or per therm cost recovery shortfall created by reduced kWh or therm sales due to DSM programs. This report will be based on non-customer-related costs approved by the ACC in the Utility's most recent rate case. The Fixed Cost Recovery Shortfall calculation shall apply to sales reductions incremental to those previously achieved and incorporated into base rates. This report shall be updated coincident with regulatory approval of applicable and relevant changes to the Utility's tariff (e.g., approved changes in non-fuel and purchase power components).

(B) Upon approval of the Fixed Cost Recovery Shortfall Report by the Commission, the Utility shall be authorized to recover the Fixed Cost Recovery Shortfall through the annual true-up of the Utility's DSM adjustor mechanism.

The Companies believe this proposal for recovering the Fixed Cost Recovery Shortfall addresses these disincentives in a clear, concise, complete and simple manner. If the Companies' proposal were adopted, all parties would know the impacts of the rule before it is approved and would not be subject to some future, undefined, process.

B. Percentage.

The Companies have proposed percentages that are very aggressive and may be difficult to achieve in even the best circumstances, especially in the rural communities served by UNS Gas and UNS Electric. In fact, the proposed percentages for the electric utilities are higher than other regional EE standards (including Colorado and New Mexico). However, as mentioned above, the Companies have made this recommendation without the benefit of a formal study to evaluate the market potential of EE or the economic impact to our ratepayers of the proposed standards. Further, none of the other parties have provided a formal study to be vetted in this workshop process to support their proposals. It is the Companies' position that a formal study is critical to establishing a reasonable energy efficiency standard that will be in the public interest and will result in just and reasonable rates. Therefore, the Companies suggest that the parties should be allowed to conduct the necessary formal studies and that those results should be incorporated, analyzed and reviewed during the rulemaking process.

C. Cost Recovery.

Most, if not all, parties agree with the Companies' position that the cost of implementing the EE/DSM programs and associated incentives can be recovered through a DSM Adjustor as an expense, capitalized/amortized asset, or a combination thereof.

D. Cost/Benefit.

All parties agree that EE/DSM programs should be cost effective. While parties have differing views of exactly how to determine cost effectiveness, the Companies believe this issue can be vetted on a case by case basis when utilities file their EE plans and address the avoided costs and other factors as described in the utilities' Integrated Resource Plans, as applicable. Ultimately, the Companies need clear direction for the Commission as to the specific definition and measurement of "cost effective". Again, appropriate studies could help shape a proper definition.

E. Incentive Mechanisms and Performance Incentive.

The Companies have proposed an incentive based on a percentage of net benefits. Other parties have proposed variations of incentives with tiers and caps. While the Companies advocate that their proposal should be adopted by the Commission, they are open to discussing their proposal along with any other proposed incentive designs.

F. Direct Load Control Credit.

Direct Load Control ("DLC") programs provide a contribution to an overall energy efficiency strategy by providing a dispatchable and reliable alternative energy source. Savings from these programs should be included as part of meeting an EE standard. DLC load reduction capability can be converted to an annual energy equivalent based on an assumed 50% annual load factor. There should be not be a minimum nor maximum subscribed to the percentage of overall savings achieved by DLC programs, letting the market diversity in each jurisdiction decide the best solutions.

G. Review.

Since this is a new process and the Companies' customers will ultimately determine the penetration of EE/DSM programs, after a few years of experience, the standard should be reviewed and adjusted as necessary.

II. <u>Consistency with Federal Standards.</u>

In order to avoid confusion, inefficiencies and duplicate but inconsistent regulation that will ultimately burden the industry and our ratepayers, the Companies contend that any EE Rules adopted by the Commission should be aligned with any federally mandated EE Standard. For the reasons stated above, the Companies would prefer that the State and Federal EE Rules be exactly the same. However, the Companies realize that the Commission may wish to advance certain policy objectives and therefore, the State Rules may deviate, where permissible, from the Federal Standard. Nevertheless, the Companies urge the Commission to implement EE Rules that are consistent with -- and in many instances mirror -- the Federal Rules, or at least have a provision stating that it is the intent of the Commission to be consistent with future Federal EE standards or requirements. The Companies argue that, at a minimum, the Commission's EE Rules should be consistent with the Federal requirements in the following areas:

a) **Measurement Methodology** – The Companies believe that the Commission's Rules should mirror the Federal requirements regarding what standard the EE Rules will be measured against. It is critical for the Companies to have consistent measurements between the Federal and State requirements in order to efficiently plan their resources/programs. Specifically, the Rules should be consistent regarding the definition the efficiency savings percentages, targets and baselines as well as the measurement and verification of energy savings.

b) **Definitions** - It is important that the Federal and State definitions are similar in order to ensure consistent regulatory treatment and avoid duplicative costs.

c) **Combined Standard** – The Companies would encourage the Commission to consider allowing the industry the flexibility to exchange renewable energy credits and efficiency standard requirements in order to meet both the Renewable Energy Standard and the proposed EE Rules in an economical manner.

Conclusion

The Companies support the Commission's desire to promote EE through programs that produce the desired results in a manner that will not harm the Companies' customers or the Companies themselves. The Companies have endeavored to make reasonable and fair recommendations that will result in effective EE programs that provide utilities the opportunity to earn a reasonable rate of return as it applies to EE while still ensuring just and reasonable rates for the Companies' customers. The Companies believe that this approach will strengthen the long-term viability of the rules. Thus, the Companies request that the Commission consider these comments, along with the previously filed proposed EE Rules, as the effective execution of any EE standard will be strengthened if they are adopted.

RESPECTFULLY SUBMITTED this 12th day of June 2009.

Tucson Electric Power Company,
UNS Electric, Inc. and
UNS Gas, Inc.

By ______________________

Philip J. Dion
One South Church Avenue, Suite 200
Tucson, Arizona 85701

and

Michael W. Patten
ROSHKA DEWULF & PATTEN, PLC.
One Arizona Center
400 East Van Buren Street, Suite 800
Phoenix, Arizona 85004

Attorneys for Tucson Electric Power Company, UNS Electric Inc. and UNS Gas Inc.

Original and 15 copies of the foregoing filed this 12th day of June 2009 with:

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Copy of the foregoing hand-delivered/mailed this 12th day of June 2009 to:

Lyn Farmer, Esq.
Chief Administrative Law Judge
Hearing Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Janice M. Alward, Esq.
Chief Counsel, Legal Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Ernest G. Johnson, Esq.
Director, Utilities Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Terri Ford
Utilities Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Barbara Keene
Utilities Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

By Mary Ippolito